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Advising Private Foundations

Despite their administrative and regulatory complexity, these philanthropic vehicles are taking off.

BY BRIAN P. MCALLISTER AND TIMOTHY R. YODER
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In the arsenal of estate planning, private foundations have traditionally ranked among the big guns. With their relative formality and extensive tax rules, they have been considered the province of the truly wealthy - people with \$1 million or more to dispose of charitably. The belief that lesser largesse could be better served by donor-advised funds and certain types of supporting organizations (see "The Rich Truly Are Different," *JofA*, April 04, page 32) is changing.

The Pension Protection Act (PPA) of 2006 has curtailed many of the tax and other advantages enjoyed by those two alternative philanthropic vehicles. Today, small family foundations with assets under \$1 million make up nearly 60% of all foundations. One factor driving this growth is the unprecedented transfer of wealth to the post-boomer generation that has begun and is likely to accelerate in coming years. Often, these small foundations are administered by family members, who rarely have expertise regarding the complex tax regulations involved.

For all these reasons, developing a niche practice in private foundations poses growth possibilities for CPA firms, according to Holly M. Pantzer, CPA, a partner with BKD LLP, one of the 10 largest CPA and advisory firms in the U.S., where her areas of expertise include advising private foundations. CPA firms are increasingly likely to be advising founding benefactors of family foundations. CPAs can be a valuable resource for monitoring compliance with the many tax laws unique to private foundations. Awareness of the nuances of private foundation laws is especially important now, given the increased scrutiny of all tax-exempt organizations by Congress and the IRS. Advisers can help prevent inadvertent but costly violations of the tax laws peculiar to private foundations. Key issues for benefactors considering a private foundation include:

- Comparisons to other options (donor-advised fund or supporting organization)
- Prohibitions on self-dealing
- Excise taxes on net investment income
- Taxes on undistributed income
- Taxable expenditures and expenditure responsibility
- Jeopardizing investments and excess business holdings

Private foundations operate exclusively for religious, charitable, scientific or similar activities as described in IRC § 501(c)(3) and are exempt from income tax but commonly pay excise taxes on net investment income and, sometimes, as penalties. They are usually funded by a single contributor, such as a family or corporation, rather than by the general public, as with a public charity. They may either directly conduct exempt activities (operating foundations) or make grants and distributions consistent with their exempt status (non-operating foundations).

Although private foundations often support other tax-exempt charitable organizations, a private foundation is not what tax law calls a "supporting organization." A supporting organization exclusively benefits, is controlled by, or operates in connection with a public charity. Nonetheless, CPAs should be familiar with the four types of supporting organizations (see Exhibit 1 for resources) when advising private foundations. Grants made to a Type III non-functionally integrated supporting organization require additional administrative and reporting requirements. In addition, grants to this type of supporting organization are not included in qualifying distributions for purposes of meeting the distribution requirements.

(EXHIBIT 1 MISSING)

PRIVATE FOUNDATION VS. DONOR-ADVISED FUND

CPAs should assist funders in determining if a private foundation is the best charitable vehicle for their needs. One alternative to establishing a private foundation is to establish a donor-advised fund with a sponsoring organization. Donors make contributions to sponsoring public charities. These funds are separately accounted for and associated with a named donor. The donor then has a reasonable expectation of being able to advise the sponsoring organization as to the distribution of these funds. The donor's role must be advisory, and the sponsoring organization must exercise full control and variance powers over the donated funds.

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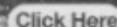
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